United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

ORIGINAL

74-1563

To be argued by
JOSEPH P. HOEY

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

Docket No. 74-1563

UNITED STATES OF AMERICA,
Plaintiff-Appellee,

—against—

PAUL LAWRENCE ROSENRAUCH,
a/k/a LAWRENCE ROSEN,
Defendant-Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

APPELLANT'S BRIEF

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APPELLANT'S BRIEF

Issue Presented for Review

The issue presented for review herein is: whether the District Court committed substantial error requiring a new trial by refusing to receive in evidence (i) records and testimony proffered to show that defendant had accounted for reimbursed expenses from Progressive Drug Co., Inc., and that such moneys were expenses and were not, as contended by the government, taxable income, and (ii) records and testimony proffered

in support of defendant's contention that certain transactions were loans to him and not as the government contended unreported income.

STATEMENT OF THE CASE

Defendant Lawrence Rosen appeals from a judgment of the United States District Court for the Southern District of New York entered on April 19, 1974, upon the verdict of a jury after trial before Judge Harold R. Tyler, convicting him of two counts of wilfully attempting to evade and defeat his income taxes for the years 1966 and 1967 in violation of 26 U.S.C. 7201 and two counts of filing false income tax returns for each of those years in violation of 26 U.S.C. 7206(1). The 7206(1) violations arose out of the same alleged transactions as the evasion of income counts; namely, failure to report income from Progressive Drug Co., which money the defendant contends was reimbursement for expenses, and the receipt of certain money from Intercontinental Hangers, Ltd. which defendant contended were loans to him and not taxable income. Defendant was sentenced to concurrent terms of 70 days on evasion counts 1 and 2; sentence was suspended on counts 3 and 4. In addition, defendant was

fined $2,500 on each of counts 1 and 2 for a total fine of $5,000 and was placed on probation for a term of three years to follow commitment on counts 1 and 2. Defendant was also directed to pay the costs of prosecution.

It is defendant's contention that he is completely innocent of the charges. He recognizes that the evidence presented close questions of fact for the jury as to the true nature of the said "expense" and "loan" transactions. If the jury had before it the defendant's evidence proferred to show the true nature of these transactions the balance could have been tipped in defendant's favor. However, we respectfully submit, the District Court erred in excluding the said evidence. A new trial is therefore required.

FACTS

The indictment, dated April 30, 1973, charged defendant with two counts of income tax violation and two counts of knowingly and unlawfully filing a false income tax return. The first and third count of the indictment dealt with the taxable year 1966. The second and fourth counts dealt with the taxable year 1967. The unreported funds alleged in counts 1 and 3 in 1966

allegedly arose from sources at the Progressive Drug Co., Inc. The unreported income for the calendar year 1967 under counts 2 and 4 allegedly arose from Intercontinental Hangers, Ltd., a Canadian corporation, and $600 allegedly received from Progressive Drug.

A. Progressive Drug Co. Payments

Richard Bertoli, a Certified Public Accountant, testified that he had been employed as a financial adviser and controller by Mr. Hanger, Inc. ("Hanger"), a manufacturer of disposable plastic hangers, from 1964 until May 30, 1968. Defendant was then the president and chief executive officer of Hanger.

He further testified that in the spring of 1966 the defendant arranged for the financing of the acquisition of Progressive Drug by Twentieth Century Industries which was at the time a major stockholder of Hanger and received a stock interest in Twentieth Century in the name of another officer of Hanger, one Benjamin Zuckerman, related to the defendant by marriage.* Bertoli acknowledged that the defendant actually rendered financial and business services to Progressive Drug.

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*Defendant testified that Hanger, not he personally, was the true owner of the Twentieth Century stock. (Infra A. 383).

Bertoli advised the defendant that it was unwise for him to be receiving funds from Progressive Drug for travel and entertainment expenses and suggested that defendant go on the payroll of Progressive. The defendant told Bertoli that he would not go on the payroll of Progressive Drug because withholding taxes would be withheld from his salary and he needed the money.

In April, 1967 Bertoli prepared the defendant's personal 1966 Federal Income Tax Return. He had prepared and distributed the W-2 forms to the defendant and to other employees of Hanger. The sums indicated on the W-2 forms were recorded on the defendant's individual tax return by Bertoli. Additionally, Bertoli caused the preparation of a Form 1099 which indicated expense moneys totalling $7,800 received by defendant. Bertoli testified further that he obtained the information concerning the $7,800 from his examination of books and records of Hanger, and that he prepared the 1099 form and the equivalent entry on the 1966 tax return of the defendant, which is Exhibit 1 in evidence.

Bertoli denied that the defendant performed any services on behalf of Progressive Drug other than

financial services and specifically denied that any activities were performed by the defendant in the development and distribution of new products. Bertoli further testified that at the time of preparing the defendant's 1966 tax return he recommended the inclusion of the moneys received from Progressive Drug as part of defendant's reportable income. Bertoli stated that the defendant told him that he did not intend to pay any tax whatsoever on those moneys and that he would not report the same.

Henry Hainick testified that he and Lawrence Press were the co-managers of Progressive Drug during 1966 and early 1967. He acknowledged that defendant played a role in Progressive Drug in that he worked on cash flows and with the financial company which was advancing moneys to Progressive Drug and that on many occasions the defendant expended sums of money on behalf of Progressive Drug for entertaining and other expenses. He further advised that during the period of time when he was connected with Progressive Drug, or specifically, during 1966, money was placed in envelopes and given to the principals of Twentieth Century and two other persons. He denied that he ever gave such an envelope to defendant

personally (A. 220). He admitted that he issued checks as a financial agent of the company for travel and entertainment expenses and that some were made payable to the defendant although no vouchers were submitted to substantiate the same.

Benjamin Goldfinger testified that he acted as controller of Progressive Drug, that after the take-over in February, 1966, at Hainick's direction, he placed cash in envelopes on a weekly basis from C.O.D. collection or cash sales at Progressive Drug and gave those to Hainick. On two occasions he also gave them to Mr. Press and on one or two other occasions gave an envelope to an "Abe" from Hanger. As part of his records he kept a looseleaf book indicating the amounts which he had taken from the cash receipts and placed into envelopes. He stated that the latter part of 1966 the accountant prepared an entry in the books of the corporation charging that money to travel and entertainment expenses. Towards the end of 1966 checks instead of cash were issued for travel and entertainment expenses. Goldfinger denied that he ever gave such envelopes containing money to the defendant. On nearly all occasions he gave such envelopes and money to Hainick.

There was other testimony in the record that defendant performed substantial services for Progressive in addition to financial and business service and that defendant incurred expenses on Progressive's behalf (A. 260-332).

The defendant testified that he performed services for Progressive Drug in addition to his regular work at Hanger; that he did so because the stock which was issued in the name of Benjamin Zuckerman was in fact payment to Hanger for the services which had been rendered to Progressive Drug by defendant on behalf of Hanger; that his interest in assisting in the cash flow and financing of Progressive Drug was done for the advancement of Hanger's stock interest, that any sums of money which he received from Progressive were received as reimbursement for actual expenditures of funds by him on behalf of Progressive. Defendant had no independent knowledge of the amount of money he received but all money which he received was reimbursement for moneys actually expended on behalf of Progressive Drug. He testified as to the extensive efforts he made on behalf of Progressive Drug to develop new sundry items for sale by Progressive which testimony was substantiated by the testimony of Grossman, Lee and Stern (A. 260-332).

Defendant categorically denied that he failed to report his true 1966 income. He admitted that he received money from Progressive for reimbursement for expenses actually incurred but had no recollection as to the amount.

Defendant's recollection of the preparation of the 1966 Federal tax return differs from Bertoli's. He had asked Bertoli who was then his confidant and friend whether all of his income was included in the 1966 tax return. Because he relied on Bertoli "one hundred percent" and because he knew that Bertoli knew everthing about his business and had examined all of the pertinent records and because Bertoli assured him "that everything is O.K." and "It's covered one hundred percent." and because he had expressly told Bertoli "never to eliminate anything from his tax return", defendant signed and filed the 1966 return (A. 404-405). It will be recalled that Bertoli had testified that he obtained the sum of $7,800 from the books and records of Hanger. When these records were offered by defendant to show the absence of any such entry in the books the government objected and the Court sustained the objection. The refusal to receive the records into evidence prohibited

defendant from producing expert testimony concerning the contents of the records. As a result the jury could not evaluate Bertoli's testimony and credibility in light of documentary evidence which would have conclusively established the falsity of his claim that the $7,800 was obtained solely from the books and records of Hanger.

B. The Intercontinental Hangers, Ltd. Payments

The jury was confronted with a clearly contested issue as to the nature of certain moneys received by the defendant during 1967 from Intercontinental Hangers, Ltd. ("Intercontinental"), a Canadian corporation and a wholly-owned subsidiary of Hanger. The issue to be determined was whether the moneys received by the defendant in 1967 were to be considered taxable income as contended by the government or loans as urged by the defendant.

Bertoli testified that he met with the defendant during the early spring of 1967 at Hanger where defendant discussed his need for additional money and his reluctance to receive it directly from Hanger for reasons unrelated to this case. Bertoli said that he arranged for defendant to receive $250 per week from Intercontinental and $150 per week for himself. Other moneys were advanced by

Intercontinental to Benjamin Zuckerman and another employee of Hanger. Bertoli reported the Intercontinental moneys received by him as income on his 1967 and 1968 tax returns and paid the appropriate tax.

The government contended that the defendant failed to declare the moneys as income. In support of its claim, the government called as witnesses two members of the Montreal, Canada, Chartered Accountants of Intercontinental. The substance of their testimony was that during the course of recording and maintaining the records in the accounting office a clerk listed the moneys received by the defendant, Bertoli, and the others from Intercontinental as administrative salaries (A. 150-151). However, when the certified audit report by the Intercontinental accountants was made the records were changed to indicate that the moneys received by the defendant and others, with the exception of Bertoli who refused to sign the confirmation of the loan (A. 154), were actually loans receivable. The accounting procedure was not unique or unusual but was a standard procedure utilized in finalizing the certified audit of accounts (A. 166).

Defendant testified that at all times he considered the moneys advanced to him by Intercontinental

to be loans and further that they were recorded on the books of Hanger as loans. In September of 1973 defendant repaid the loans pursuant to the demands of Hanger.

Defendant unsuccessfully sought to introduce corporate reports filed with the S.E.C. and financial reports to stockholders to establish that Hanger in its public disclosures treated this transaction as a loan to defendant and as an account receivable on its books and records. The denial of the introduction of the records into evidence to substantiate the claim of the defendant that the moneys were actual loans due and owing to Hanger deprived defendant of the right to have the jury examine the reports to determine whether in fact he was telling the truth.

ARGUMENT

THE REFUSAL OF THE DISTRICT COURT TO ADMIT EVIDENCE AND TESTIMONY PROFFERED BY THE DEFENSE CONSTITUTED PREJUDICIAL ERROR ENTITLING DEFENDANT TO A NEW TRIAL

The validity of defendant's 1966 and 1967 tax returns turned to a large extent on the jury's interpretation of two transactions: first, whether certain moneys were reimbursed business expenses from Progressive Drug Co., Inc., as contended by defendant, or unreported taxable income, as the government charged; and second, whether moneys advanced by Intercontinental Hanger, Inc. to defendant were loans or unreported taxable income as contended by the government.

In support of the first and third counts of the indictment the government offered proof that $4,600 received by defendant from Progressive Drug represented unreported taxable income. Defendant contended that the said $4,600 was not income but was reimbursed expenses received from Progressive Drug for expenses actually incurred by him and that the $4,600 was reported to the Internal Revenue Service on a Form 1099 which set forth the receipt by

defendant of $7,800 in expense money including that $4,600 and the same was included in his 1966 federal income tax return which is Exhibit 1 in evidence.

The government's principal witness Richard Bertoli testified with respect to the "Progressive transaction" on two occasions that he set forth $7,800 reimbursed expense money on defendant's 1966 tax return, and that he had obtained information with respect to the said $7,800 allegedly received by defendant from Mr.Hanger, Inc. from the books and records of that corporation (A.23,24).

If Bertoli was correct that the $7,800 was received from Mr. Hanger,Inc., defendant's defense that a substantial portion of the $7,800 was received from Progressive Drug would have been seriously undermined. Thus, it became of critical importance upon the trial to determine exactly what the books and records of Mr. Hanger,Inc. contained with reference to expense payments to defendant.

As noted, defendant denied that he received $7,800 from Mr. Hanger,Inc. and testified that the $7,800 figure represented the aggregate total of all

expense moneys received by him, including the $4,600 from Progressive Drug (A. 403, 404, 405, 406).

Defendant accordingly proffered the books and records of Mr. Hanger to show that he had not received these expense moneys from Mr. Hanger and that Bertoli's testimony was incorrect (A. 335-352).

However, the Court refused to admit defendant's offer of proof and supporting testimony by Mr. Hanger's comptroller about the books and records of that corporation, as a result of which an important documentary aspect of defendant's case was excluded and the jury was forced to pass on the conflicting testimony without the benefit of that documentary evidence. See, United States v. Wertheimer, 434 F. 2d 1004 (2nd Cir. 1970); United States v. Dunn, 299 F. 2d 548 (6th Cir. 1962).

Similarly, with respect to the Intercontinental transaction, to substantiate his contention that these funds were loans and not income, defendant unsuccessfully offered in evidence the corporate reports filed with the SEC and the financial reports to stockholders to establish

that Hanger in its public disclosures treated this transaction as a loan receivable. Because the Court excluded this evidence, the jury could not evaluate the truth of defendant's testimony in light of corroborative documentary evidence. See, United States v. Klock, 210 F. 2d 217 (2nd Cir. 1954).

Defendant's proffered evidence and testimony could have raised substantial questions pertaining to the basic issue of guilt or innocence. It is axiomatic that all relevant proof must be received. This Court has often reversed and ordered new trials where a defendant was unduly restricted in presenting his case. United States v. Wertheimer, supra; United States v. Espinoza, 406 F. 2d 208 (2nd Cir. 1969); United States v. Klock, supra; United States v. Peach Mountain Coal Mining Company, 161 F. 2d 476 (2nd Cir. 1947). And, see also, United States v. Paquet, 484 F. 2d 208 (5th Cir. 1973), where it was noted (at p. 211):

> "The prosecution cannot give its version of a matter and thereafter muzzle the defendant."

Moreover, as pointed out by this Court in United States v. Werner, 160 F. 2d 438, 443 (2nd Cir. 1947):

> "...in cases of any doubt the right course is not to exclude."

In United States v. Wertheimer, supra, defendant was convicted of submitting fraudulent claims to a United States agency for payment for goods which he had not in fact shipped. At that time, regulations required shipment before payment. On each invoice, defendant signed a certificate stating that the materials had been shipped, but they had not been shipped on the dates stated on the invoice. They were delivered several months later.

On appeal, the appellant contended that the trial court erred in refusing to allow the defense to introduce evidence showing that the ordered materials were eventually delivered. This Court agreed, stating:

> "Although there may technically have been no error since the indictment charged false certification on the invoice for payment rather than fraud in non-compliance, the Government took

> unfair advantage of the appellant by deliberately giving the jury the impression that the Government had paid approximately $25,000 to the appellant for materials never delivered, and was cheated out of its moneys. The Government, after having been allowed to show payment, should not have objected to the defendant's showing delivery." 434 F. 2d 1004 (2nd Cir. 1970)

In United States v. Klock, supra, the defendant was convicted of misapplying moneys and credits of a bank by causing the bank to pay insufficient funds on checks without charging the checks against the account and conspired to deceive the bank's officers and the bank examiners.

At trial, Klock sought to introduce evidence that the responsible officials of the bank had authorized the overdrafts and if there was authorization, then they were merely loans and defendant's conduct did not then violate statutory provisions. This defense, if proved, would have exculpated Klock.

Klock offered in evidence and the court excluded bank ledgers showing $60,000 of unaccounted for overdrafts of various depositors, financial statements of a corporate depositor showing that the bank had allowed that company to overdraw its account repeatedly and testimony of a

former bank employee that he had known of the bank's practice of treating overdrafts as loans.

This Court observed that the trial judge "apparently assumed that authorization of [the defendant's] conduct, if proved, would be no defense... it would merely be approval of crimes committed by [the defendant]...Acting, apparently on that assumption, the judge seriously erred." 210 F. 2d at p. 220.

> "This evidence would have been relevant to show that the bank had knowledge of overdrafts by its depositors and that the bank had allowed such overdrafts not only in isolated instances but frequently over a long period of time. We think the defendants had a right to produce this evidence to show the existence of a bank policy of allowing overdrafts and, further, had the right to cross-examine bank officials as to whether they reported to federal and state officials the...Company's overdrafts as overdrafts." 210 F. 2d, pp. 221-2.

The Court declared that had these exhibits been received into evidence the jury could have then reasonably inferred that the bank's officers considered these overdrafts to be loans not prohibited by statute and had

authorized the defendant to omit posting them as debts against depositors' accounts.

> "The same reasoning applies to defendant's excluded exhibits of directors' reports and reports to the State Banking Department... Defendants were therefore entitled to introduce evidence tending to show that they were acting in accord with the bank's practice of making loans informally, and that the bank had acquiesced in [the defendant's] bookkeeping in respect to these loans." 210 F. 2d, 217, 221.

Just as Klock "had the right to produce evidence showing a bank policy" to treat overdrafts as loans, defendant here was entitled to offer documentary evidence in the form of SEC and stockholder reports to show that the Intercontinental moneys were loans to him and were so treated by the corporation.

In United States v. Peach Mountain Coal Mining Company, supra, this Court reversed a conviction for unlawful sale and delivery of anthracite in violation of a wartime regulation. It was found that the record showed that evidence persistently offered by the appellant to prove the circumstances under which the coal was sold was

excluded by the trial court and was reversible error since it prevented him from showing, as he insisted he could, that his conduct was not in violation of the regulations pursuant to the statute.

> "The excluded proof was relevant ...Proof has to be introduced in a trial step by step. Because the attempt to show compliance with [the regulation] was nipped in the bud, so to speak, we have no means of knowing whether it would have appeared in full flower had the trial been without error. It is enough for present purposes that the error in excluding the offered evidence prevented the defendants from presenting their facts in full. They were unable to take advantage of the provisions of the above section, as proof of a compliance with it would have entitled them, and that requires a new trial. 161 F. 2d 476, 479.

United States v. Dunn, 299 F. 2d 548 (6th Cir. 1973) reversed a conviction on an indictment for making false and fraudulent statements in a Federal Housing Administration transaction and for substantive violations. The Sixth Circuit Court found prejudicial error in the exclusion of evidence showing that the appellant had made four payments on the property in question, thus evidencing his intent to consummate the transaction.

The government's evidence made a sharp issue of whether these payments had been made and the defense sought to show in cross-examination of a prosecution witness that the payments had been made. The trial court excluded the evidence on the ground that the subject was not germane to the witness's direct examination.

The Court of Appeals was "not persuaded to treat this matter as insignificant and without prejudice to the defendant" and held that the defendant having testified to the payments was entitled to the disinterested corroboration by the official records of the mortgagee.

CONCLUSION

The judgment of conviction should be reversed and a new trial ordered.

Respectfully submitted,

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June 25, 1974.

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